



## Positive inflation surprise could strengthen support for a smaller rate rise

### Highlights

- Statistics South Africa (Stats SA) reported headline inflation (CPI) at 7.2% year-on-year (y/y) for December 2022, a welcome drop from 7.4% y/y in November.
- The December outcome was in line with the median Reuters consensus of 7.2% y/y.
- The main contributors to headline inflation were food and non-alcoholic beverages (NAB), housing and utilities, transport and miscellaneous goods and services.
- Core inflation was reported at 4.9% y/y in December, lower than the November print of 5%. This is a positive surprise relative to the Reuters median consensus of 5.1%.
- On an annual average basis, headline inflation for 2022 breached the upper limit of the SA Reserve Bank's (SARB) inflation target range at 6.9% while core inflation averaged below the midpoint of the target band at 4.3%. This was in line with our projections of 6.9% and 4.3%, respectively.
- Persistently high inflation in 2022 disproportionately impacted vulnerable consumers. Households in expenditure deciles 1 and 2<sup>1</sup> experienced inflation rates of 8.5% and 8.1%, respectively, in 2022.
- The global diesel crisis resulted in diesel prices being 44% higher than in 2021, which explains why transport inflation featured as a strong driver of inflation last year. However, transport inflation has been decelerating since the peak in July due to lower international oil prices.
- Despite a further decrease in the price of Brent crude oil to US\$81/bbl in December 2022, petrol prices (inland 95) increased by 59c/l in December, but the Central Energy Fund (CEF) announced a significant decrease of R2.06/l for January 2023.
- Food and NAB replaced transport as the largest contributor to inflation in December. However, food inflation is showing signs of having peaked in November 2022.
- The approved increase of 18.65% in the electricity tariff announced by the National Energy Regulator of SA (Nersa) for the 2023/2024 financial year followed by an increase of 12.74% in the next financial year is expected to impact inflation between 0.1% and 0.2% given the 3.7% weight of electricity in the consumer basket. Moreover, it is expected to feed into inflation expectations, which came in higher across all time horizons surveyed in December 2022.

<sup>1</sup> Decile 1 – up to R20 140 per annum  
Decile 2 – R20 141 up to R33 619 per annum

- Although we had initially anticipated an interest rate increase of 50 basis points at this month's Monetary Policy Committee (MPC) meeting, the downward surprise in headline and underlying inflation, subdued services inflation and signs of easing global inflation point to a strengthened case for a small rate rise of 25 basis points at the upcoming meeting. We expect the current interest rate hiking cycle to peak at 7.5% by the end of the first quarter, given that real interest rates, based on forward-looking inflation, are already in positive territory.

## Core inflation surprised positively in December 2022

According to Stats SA, headline inflation for December 2022 was 7.2% y/y, down from 7.4% in November 2022. This represents the second consecutive drop in the inflation rate following the higher-than-expected rate of 7.6% recorded in October 2022. The December inflation rate was in line with the Reuters median consensus of 7.2% y/y. However, on a month-on-month (m/m) basis, headline CPI was 0.1% more than a month ago.

The main drivers of headline inflation were food and non-alcoholic beverages (NAB) (12.4% y/y), transport (13.9% y/y) housing and utilities (4.1% y/y) and miscellaneous goods and services (4.9% y/y).

Chart 1: Owners' equivalent rent below the mean



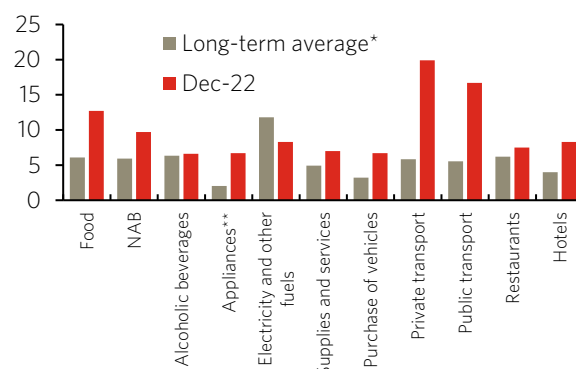
Source: Global Insight, Momentum Investments

Around 20% of the basket is surveyed once every quarter, which makes December a highly surveyed month. Items surveyed in addition to the monthly surveys included rental costs, domestic workers' wages, car insurance, private sector hospital fees, selected sport games' tickets as well as taxi, train and bus fares. Owners' equivalent rent accounts for 12.99% of the total basket (the largest single component of CPI) and increased by 2.8% y/y in December 2022, lower than the 3.2% recorded in September. As illustrated in chart 1, owners' equivalent rent ramped up following the

trough during the COVID-19 pandemic. However, it is still below the long-term average. Despite the softer-than-expected outcome, we expect inflation in this category to rise in the coming quarters due to higher demand for property rentals relative to available supply. Weak rental inflation has kept a lid on services inflation, which decelerated for a second consecutive month. This bodes well for the expected rate of acceleration in underlying inflation in the coming months.

Core inflation of 4.9% y/y for December 2022 positively surprised market expectations of 5.1% y/y. Moreover, the outcome was lower than the 5.0% y/y recorded in November. This provides tentative signs of inflation easing at the underlying level. However, the number of categories recording increases of above 6% increased from 11 in November to 12 in December indicating that inflation pressures remain broad-based. Moreover, the December CPI in most of these 12 categories (except electricity and other fuels) is above the long-term average as illustrated in chart 2.

Chart 2: Global food and fuel price pressures and inflation in rand-sensitive components have driven inflation higher



Source: Global Insight, Momentum Investments

\*Long-term average is calculated from 2009 to 2021

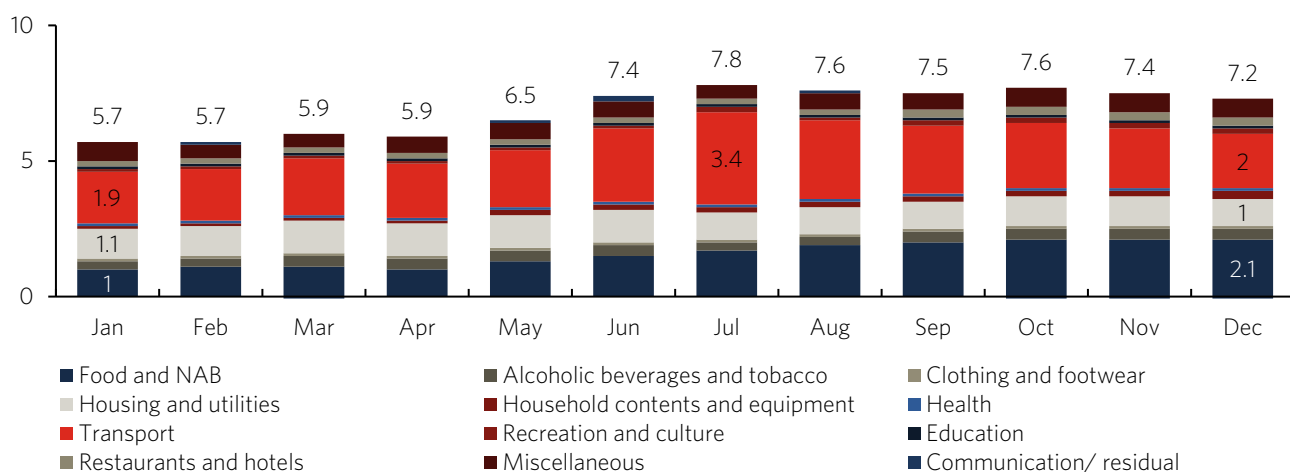
\*\*Appliances, tableware and equipment – new addition to the list of above 6% increases

## Review of inflation in 2022

The year 2022 was characterised by consistently high inflation. Since January 2022, inflation continued to rise and peaked at 7.8% in July 2022, the highest reading since May 2009 (8% y/y). Throughout the year, the main drivers of inflation included transport and food and NAB as illustrated in chart 3. This was largely due to supply chain disruptions as a result of the Russia-Ukraine war which led to high international oil and food prices. On average, Brent crude oil was 43% higher in 2022 relative to 2021 and global food prices were 14%

higher, on average, over the same period. Transport inflation peaked at 25% in July 2022. Moreover, the December reading of food and NAB at 12.4% is signalling a peak in November. However, food and NAB were the top drivers of inflation in December and is expected to remain as such given the anticipated sticky food inflation. Therefore, lower inflation in recent months may largely be attributed to lower transport inflation as a result of lower oil prices.

Chart 3: Main drivers of inflation in 2022 included transport as well as food and NAB (contribution)

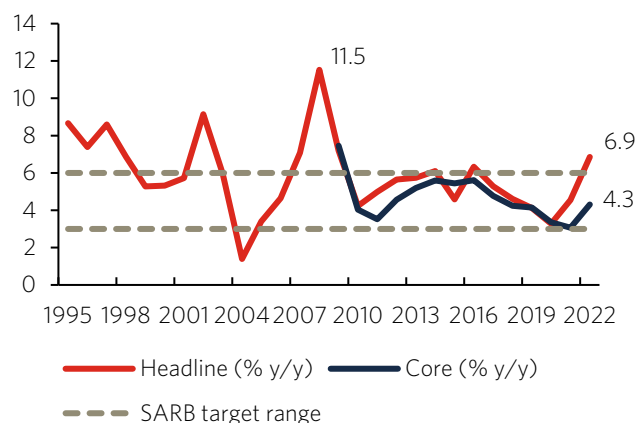


Source: Global Insight, Momentum Investments  
Read the legend from left to right

Headline inflation averaged 6.9% in 2022, breaching the upper band of the SARB's inflation target range of 3% to 6% as illustrated in chart 4. This was in line with our forecast and marks the seventh occurrence of an upper limit breach since the introduction of inflation targeting in February 2000.

On the other hand, core inflation was contained below the mid-point of the target range at an average of 4.3% for 2022, in line with our forecast as well. This was the highest annual average since 2017.

Chart 4: Headline inflation averaged above the inflation target range in 2022

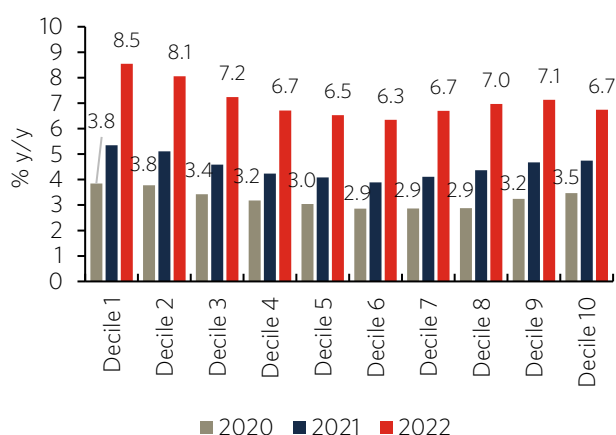


Source: Global Insight, Momentum Investments

While inflation affects everyone, the extent of the impact differs among households because the basket of goods purchased differs per household depending on their respective income levels.

As indicated in chart 5, the inflation rate of the various expenditure deciles varies. Despite higher inflation experienced across all the deciles, there was more variation in 2022. Households in deciles 1 and 2 experienced inflation rates of 8.5% and 8.1%, respectively, in 2022. This is because the lower deciles spend a higher portion of their disposable income on food and transport (the main drivers of inflation in 2022) compared to the upper deciles. The higher inflation for decile 8 and 9<sup>2</sup> may be attributed to the higher cost of private transport (fuel).

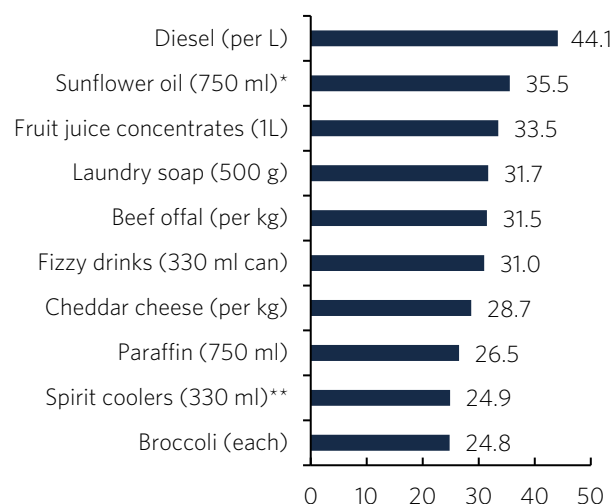
**Chart 5: Decile 1 and 2 disproportionately impacted by inflation**



Source: Global Insight, Momentum Investments

Furthermore, there were exorbitant price increases in specific goods. The item which saw the largest increase over the 2022 period was diesel which averaged 44.1% higher than in 2021 due to the global diesel shortage. As illustrated in chart 6, the majority of the top 10 largest price increases were in food items owing to supply chain disruptions and the spillover from fuel prices. Moreover, *News24* reported that the Competition Commission found that there is a high and growing concentration along the sunflower oil value chain which created a risk for higher prices. Although sunflower oil process prices increased by 72% in 2022, sunflower oil increased by 35.5%, which means retailers absorbed some of the price increases. Other retailers may have also practiced partial price absorption.

**Chart 6: Largest price increases over 2022 (%)**



Source: Global Insight, Momentum Investments

\* Including canola oil

\*\* Spirit coolers or cider

## Food inflation eased but remains elevated

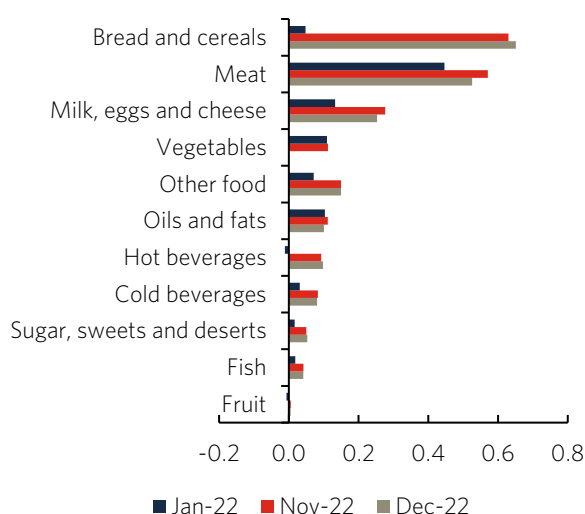
Local food inflation was 12.7% y/y in December 2022, down from 12.8% in November. This was the first decrease since April 2022. Food inflation was largely driven by bread and cereals (20.6% y/y) and meat (9.7% y/y) as illustrated in chart 7. However, the rate of increase in the meat category has decreased from the previous month. Moreover, the rate of increase in the

price of oils and fats has been decreasing from a peak of 37.6% in July 2022 to 22.4% in December. The slight deceleration in food prices may partly be attributed to the Black Sea Grain initiative which has enabled increased volumes of food exports from Ukrainian ports to global markets during the war.

<sup>2</sup> Decile 8 – R143 175 up to R199 920 per annum  
Decile 9 – R199 921 up to R312 246 per annum

According to the European Council, this agreement has helped address the global food security crisis and lower grain prices. As of 5 December 2022, 45% of the exports since the agreement was brokered was maize and the rest included wheat (28%), sunflower products (13%) and other produce (13%). However, the European Council states that there are still significant export backlogs which imply ongoing global shortages.

**Chart 7: Contribution to food inflation (%)**



Source: Global Insight, Momentum Investments

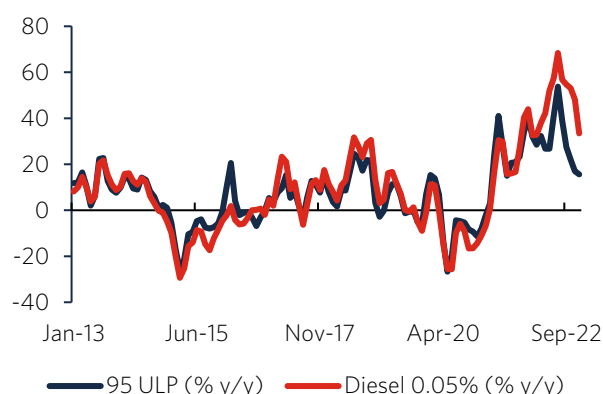
## Lower transport inflation owing to lower international oil prices

Transport inflation decelerated to 13.9% y/y in December 2022 from 15.3% in November. This was the fifth consecutive drop since the peak in July. The largest decrease was in public transport, from 20.5% in November to 16.7% in December. This is positive for consumers who rely solely on public transport as these fares are generally stickier downwards.

The price of Brent crude oil eased further to an average of US\$81/bbl in December from US\$91.4/bbl in November. Despite the decrease, the price of petrol (inland 95) increased by 59c/l in December to R23.46/l. On the other hand, diesel (inland) decreased by 157.19c/l to R23.92 according to the CEF. However, the CEF announced decreases of over R2/l for both petrol and diesel for January 2023 which will contribute toward further lower transport inflation.

Fruits were in disinflationary territory for most of 2022 because this category is not extensively influenced by global conditions as SA is a net exporter of fruits. Furthermore, the Agricultural Business Chamber (AgBiz) reported increased activity in certain vegetables and fruits in the second and third quarter. In December 2022, fruit inflation was low at 1.6%, down from 1.7% in November. Meanwhile, inflation in all the other 10 food groups was above 6% in December indicating persistence in food inflation.

**Chart 8: Increase in fuel prices edging lower**



Source: SA Premium Industry Association, Momentum Investments  
Data available until January 2023

While the prices of petrol and diesel remain elevated, chart 8 illustrates that the rate of increase has slowed significantly since July 2022. The y/y growth in petrol

prices peaked at 53.8% in July and was down to 15.6% in December. Similarly, diesel inflation peaked in July, although at a higher rate of 68.4% but was down to 33.4% by December.

As indicated in the previous inflation note, we still anticipate lower average international oil prices in 2023 to support a further deceleration in transport inflation.

In the December 2022 Oil Market Report, the International Energy Agency (IEA) stated that oil demand increased during 2022 but is expected to be slightly lower in 2023. However, they indicate that the

re-opening of China from its COVID-19 lockdowns could lead to a quicker demand recovery for oil going into 2023, which poses an upside risk to Brent crude oil prices. However, the report further reiterates that world oil supply will be higher next year which could cap prices.

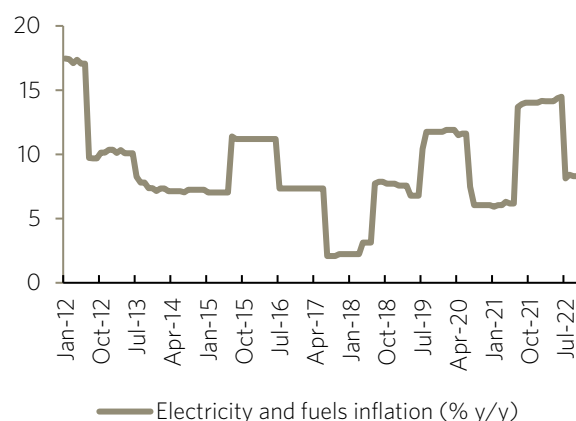
The US Energy Information Administration (EIA) forecasts Brent crude oil to average U\$83/bbl in 2023, lower than the average of US\$100.7/bbl in 2022. However, risks to international oil prices, stemming from possible import restrictions in light of the ongoing war, remain.

## Electricity tariff expected to put pressure on inflation expectations and actual inflation outcomes

The Bureau for Economic Research (BER) published the inflation expectations ahead of the MPC meeting for the first time this quarter, as it is usually published on the same afternoon as the interest rate decision. Short and longer-dated inflation expectations were higher in December compared to the September results. The adjustment for the 2022 expectation was anticipated given that the December CPI print is the last one for the year and there is knowledge of the previous readings. However, the expectations for the other time periods surprised negatively. The inflation expectation for 2023 came in at 6.1%, higher than the SARB's forecast of 5.4% in the November MPC statement. The higher expectation stemmed from trade unions and business people (i.e. the price setters of the economy) while the expectation of analysts remained unchanged.

According to the BER, the inflation expectation survey was conducted between 21 November and 8 December 2022. This was before Nersa announced the 32% increase in electricity tariffs over the next two years (18.65% for financial year 2023/24 and a further 12.74% for financial year 2024/25). An increase of this magnitude will place upward pressure on inflation expectations and actual inflation.

Chart 9: Larger spike expected from the 18.65% tariff



Source: Global Insight, Momentum Investments

The impact of the tariff on headline inflation will be seen in the July and August 2023 CPI prints because electricity is surveyed biannually during those months. The tariff increase granted to Eskom in 2022 was 9.61% meaning this year's tariff is 94% higher. As such, we can expect a larger spike in electricity inflation in 2023 followed by a slight decrease in 2024. Overall, the tariff adjustments lift our headline figures by between 0.1% and 0.2%, given the 3.7% weight of electricity in the consumer basket.

## Interest rate implications

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In our view, the SARB reacted early to rising inflation pressures by starting to raise interest rates in November 2021. Interest rates have been lifted by a cumulative 350 basis points since. While the MPC has indicated that the environment is still accommodative given negative real rates, they have signalled a move toward “removing the foot off the accelerator”. Moreover, real interest rates based on forward-looking inflation are no longer in negative territory.

Today’s softer inflation outcome, subdued services inflation, contained core inflation, a firmer rand and easing global inflation are supportive of easing the magnitude of interest rate hikes. We anticipate an additional 50 basis points in interest rate increases leaving the peak of the cycle at 7.5% by the end of the first quarter of 2023.

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